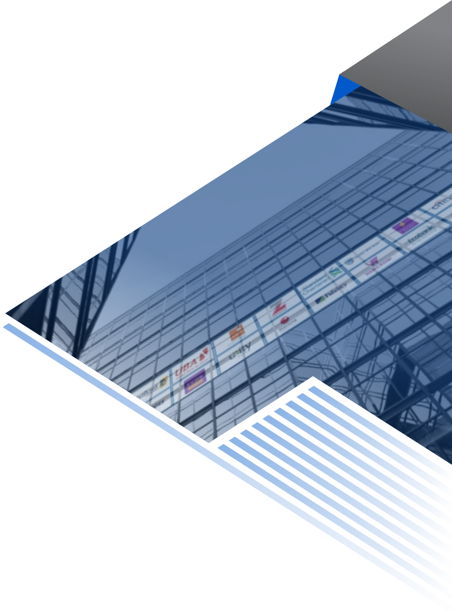
Debtors™

NPLs & Bad Debtors -
The Case for A New Industry Approach

May 2020



Executive **Summary**

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This report represents a culmination of a detailed review of the credit experiences of local Nigerian banks in the last two decades and reveals the challenges of a local lending cycle that has seen lenders become victims of the tyranny of bad and delinquent debtors.

"There is a defined gulf between credit and character. If you doubt this, ask any banker; He will advise that character is nice. But it is not collateral"
-Evan Rhys, Poems from the Ledge

The report makes a case for a new approach to the lending cycle to ensure that integrity, professionalism and evidence-based best lending practices are strictly followed to guarantee the sustain ability of the financial system and the prosperity of the larger economy.

Having invested years of resources in evaluating and monitoring the performance of the Asset management Company of Nigeria (AMCON) in the resolution of delinquent loans acquired from banks and the massive N6trn loan assets unrecovered by the institution, and the increasing frustration of its asset management professionals (AMPs) who have found the convoluted debt recovery process soul-crushing and uninspiring, redesigning the delinquent debtor management algorithm has become inevitable. The nature of this new framework is laid bare as the report explains why things can no longer remain the same. The strategic imperatives of a post novel coronavirus (COVID-19) world is to make the new lending environment too toxic to accommodate bad borrower behaviour. That being said, the new environment would also play to the inalienable rights of borrowers to access loans and pay back within the norms of revised lending terms if unavoidable circumstances such as the global COVID-19 pandemic occurs and is understandably outside the control of either lenders or borrowers.

"For economic growth to become visceral, the tyranny of the debtor over the creditor must be discouraged."

A case is made for the **Federal Competition and Consumer Protection Commission (FCCPC)** to be alive to the changing requirements of its responsibilities as business uncertainty and external shocks become increasingly common and evidently more damaging than in the past. For example, the Council has not spoken about the potential for a likely worsening of bank loans and advances as businesses see their turnovers and hence profits wiped out by the consequences of COVID-19. The council has also been quiet on the issues of the rights of borrowers and the potential loan resolution mechanisms that are available to solve conflicts between borrowers and lenders which are outcomes likely to accelerate in the coming months of 2020.

The FCCPC in a post COVID-19 world must become proactive rather than reactive. The digital register of delinquent debtors could easily raise issues of consumer privacy but in a situation where the consumer breaches the original terms of an established loan contract the issue of privacy may be considered mute. As noted earlier, ***for economic growth to become visceral, the tyranny of the debtor over the creditor must be discouraged***.

In the past the emphasis was on Investor protection but in the new economic landscape loan creation will be just as important as debtor integrity and so debtor protection would become a new ballgame that umpires must watch closely to ensure equity and fairness in favour of all parties to the lending process, lenders and borrowers alike must operate with utmost good faith, in other words entering loan transactions with Uberrimae Fidei. After the COVID-19 pandemic has abated the Nigerian economy will not spin on the head of a pin but on the integrity of its credit system.

Linking A New Reality

The debtorsafrica.com report provides interesting related links that expand the credit market outlook of principal money market actors, regulators and financial analysts on issues around credit markets in Nigeria and how the market needs to evolve to carry the burden of a nation in a hurry to meet the expectations of a young, virile and digitally savvy population.

"The various links in the report allow users of the document to survey the state of the lending business in Nigeria, the institutions that are the dominant providers of credit and the challenges credit providers have had with delinquent debtors."

The various links in the report allow users of the document to survey the state of the lending business in Nigeria, the institutions that are the dominant providers of credit and the challenges credit providers have had with delinquent debtors. The report notes that the **Asset Management Company of Nigeria (AMCON)** has found it difficult to meet the responsibility of its mandate as a result of early errors in both loan acquisition and funding aspirations. AMCON large loan portfolio has no immediate exit valve. The institution and/or its successor will be stuck with loans that may never be recovered, the painful experiences of AMPs in trying to achieve sizable recoveries speak to the dim likelihood of loan writebacks.

The End of Hiding Behind A Finger

If there is one characteristic that will define the success of winners and losers in the new loan ecosystem it is transparency, banks hiding delinquency behind a stump of grass will soon discover that their nakedness is as clear as that of a day-old baby. The only way for banks and their borrowers to create a sustainable credit environment is for them to stand digitally undressed, with the delinquent borrower's character open to the world to see and make judgment calls.

"If banks do not publish the list of their delinquent debtors on a searchable data base, they create a systemic challenge that hurts all lending institutions and gives delinquent debtors an avoidable advantage in gaming the credit system."

A bank must become as transparent as its borrowers to validate its credit process, no bank can claim transparency without a digital footprint that enables engagement with recalcitrant and delinquent borrowers in the court of character evaluation and credit history. If banks do not publish the list of their delinquent debtors on a searchable data base, they create a systemic challenge that hurts all lending institutions and gives delinquent debtors an avoidable advantage in gaming the credit system. ***A Searchable data base of delinquent borrowers enables fast assessment of the character of a prospective customer. Of equal importance is that investors can use the data base as a starting node for assessing the quality of management of a business they intend to either partner or invest in.***

Credit agencies can also make use of the data base as a source of quickly searching the credit position of a number of loan applicants across lending institutions. The data would serve as a backup fact check to information already in their possession.

They would also benefit from the periodic reports and evaluation of domestic loan markets across the African continent and add this body of knowledge to the refinement of their credit reports and assessment of individual borrowers and the state of the credit exposure of different industries continent-wide.

The Post COVID-19 Age of Credit

“The digital register would be managed by each contributor and would be the responsibility of such contributor to update the status of the loan.”

Lenders are condemned to a new age. An age where the character of borrowers must be established as a more critical and pronounced part of the lending process. The review of a borrowers character as depicted by a borrowing history (captured by Credit Bureaus) and a digital registry of delinquency (captured by debtorsafrica.com) will combine to add rigour and sharpness to the process of approving loans. In the post COVID-19 period loan default and delinquency will naturally escalate. However, part of the process of default mitigation would be debt resolution compelled by negotiations around loan workouts, this would be the preferred option for most borrowers as a digital registry of delinquency would provide a permanent public record of hardcore loan indebtedness until resolution with the lending institution. The register would be updated by the lending institutions as the borrower makes good on paying down agreed outstanding liabilities.

The digital register would be managed by each contributor and would be the responsibility of such contributor to update the status of the loan. Where a debtor pays in full and final agreement with the loan work out arrangement with the lender, the contributor (lending institution) would be expected to remove the name of the debtor and the debtors loan details from the schedule of delinquent debtors on the loan register on the site.

In subsequent reports, debtorsafrica.com in collaboration with its partner Proshare Nigeria Limited, would include a deep dive on sectors adversely affected by COVID-19 and the implications for the sectoral credit status of each industry.

SECTORS GAINERS AND LOSER

Gainers	Loosers
E-commerce - Alibaba, JD.com	Auto industries - Hyandai, Toyota, General Motors
Health - Clorox, Purell, Lysol	Tourism/hospitality - Intrepid travel, Globus, Topdeck
Online Entertainment- Youtube, Netflix	Airlines - British airlines, Ethiopian airlines, Delta airline
Online gaming operations- Tencent, Netease and CMGE	Electronics - Sony, Samsung, Apple

Sectors that would likely be most severely affected by loan delinquencies once the pandemic is over would include, but would not be limited to, the following:

- Airline sector
- Hotels and Hospitality sector
- Transportation sector
- Logistics sector
- Manufacturing sector (supply chain and cash flow disruptions)
- Entertainment sector
- Large Retail sector (Shopping Malls)
- Oil $ Gas sector
- Power sector
- Financial services sector
- Fintech sector (short-term credit payments)
- Fashion and Clothing sector

Fintech companies in particular could have a harsh time in loan recoveries post COVID-19 as the majority of them do not have transparency mandates that would support their recovery process. A situation where many people would have lost their jobs during the COVID-19 period would make it difficult to enforce recovery as the delinquency would be more a problem of revised individual cash flows than any deliberate attempt at the avoidance of loan repayment.

"The price shocks in the oil and gas sector and the cost recovery difficulties in the power sector made for a cocktail of problems that banks have found difficult to handle."

The Realities of Rising Loan Impairments

Nigerian banks, at different times, have had to face bad patches of lending cycles with non-performing loans as a proportion of loanable assets rising steadily as liquidity shrank. More recently, this was seen in bank statement of financial position between December 2015 and December 2018 when large-sized banks saw their loans to the power and energy sector and the oil and gas business spiral into trouble. The bigger money centre banks (DMBs) were more severely affected than their smaller counterparts as asset concentration amongst the bigger banks was more noticeable than their smaller rivals. The high credit concentration of large cap local banking institutions meant that they were more vulnerable to external shocks. The price shocks in the oil and gas sector and the cost recovery difficulties in the power sector made for a cocktail of problems banks found difficult to handle. Between 2015 and 2018 bank statements of financial position had been pressed into a corner. In 2018, in particular, the implementation of the international financial reporting standard Rule 9 (IFRS9) on impairment provisions on a ***fair market value*** basis meant that

Oil & Gas Steam Rollers and Power Headaches

"The oil majors were victims of both uncontrollable external factors and disappearing business rationale."

The downturn in the international oil market between 2015 and 2016 saw oil prices tumble from over US$114 per barrel in July 2015 to US$52.29 per barrel in June 2016. The reversal of international oil price fortunes between 2015 and 2016 resulted in a decline in operating cash flows and a thinning of operating revenues which flattened profits before tax, depreciation and amortisation (EBITDA). The dramatic fall in oil revenues between 2015 and 2017 led to a dip in cashflows and a fall in cash flow interest cover. The mild recovery in oil prices between 2017 and 2018 resulted in a modest recovery of revenues amongst oil companies but did not lead to a strong enough increase in net sales to cope with the accumulating finance charges. The harsh fiscal position of the oil companies was reflected in the difficulties they had in meeting growing credit obligations between 2015 and 2019. The oil majors were victims of both uncontrollable external factors and disappearing business rationale. The assumptions which made business sustainable were gradually but clearly being eroded by sliding global oil prices, excess international supply and persistent manufacturing inefficiency. The oil and gas "***prosperity illusion***" was fading fast and banks were beginning to feel the effects of rising impairment charges.

Table 1: Crude Oil Prices 2015-2017 ($/pb)

2015

Months	Jan.	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
Crude Oil Price ($/pb)	48.81	58.09	56.69	57.45	65.08	62.06	57.01	47.09	48.08	48.86	44.82	37.8

2016

Months	Jan.	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
Crude Oil Price ($/pb)	30.66	31.7	37.76	41.59	47.01	48.46	45.25	46.15	47.43	50.94	45.25	53.48

2017

Months	Jan.	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
Crude Oil Price ($/pb)	55.01	46.39	52.13	52.94	50.57	47.42	49.01	51.64	56.79	58.46	63.56	65.11

Source: CBN, Proshare Research

The problem with power sector credit, on the other hand, was that most of the companies that were given distribution licenses (Discos) were established on business models that involved high capital leverage (with expectations of high return on equities (ROEs)), this was a mistake on both the part of the companies themselves and the banks that financed them. The high early leverage of the businesses of power sector distribution companies meant that cost recovery had to be large and fast to prevent credit default acceleration. Unfortunately, the ability of discos to recover charges from customers was unimpressive thereby shattering the initial cash flow projections upon which their business models were premised. The cash flow miss-hits resulted in a few banks tallying up heavy loan loss provisions and compressing operating earnings. The problems of local Nigerian banks appear to be that of cyclical lending exuberance similar to that of the cyclical investor exuberance that characterizes the Nigerian stock market from time to time. Nigerian banks (especially the bigger ones) seem to find it difficult to contextualize their credit appraisal memorandums (CAMs) and lend against most likely business scenarios. The desire for bragging rights over the relative size of their loan book and profits in the last decade created the foundation for the massive loan recovery problems that manifested between 2005 and 2018 (2019 saw a slowing down in the pace of lending until the Central Bank of Nigeria (CBN) decided to increase the loan-to-deposit ratio (LDR) of banks to 60% by September 2019 and 65% by December 2019).

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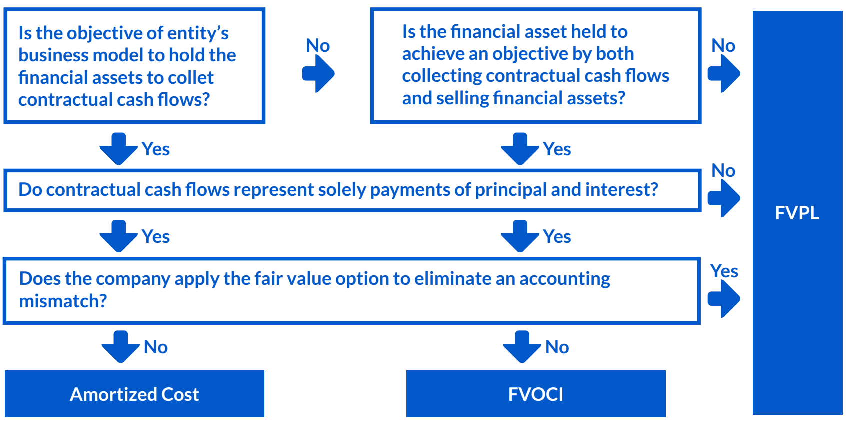
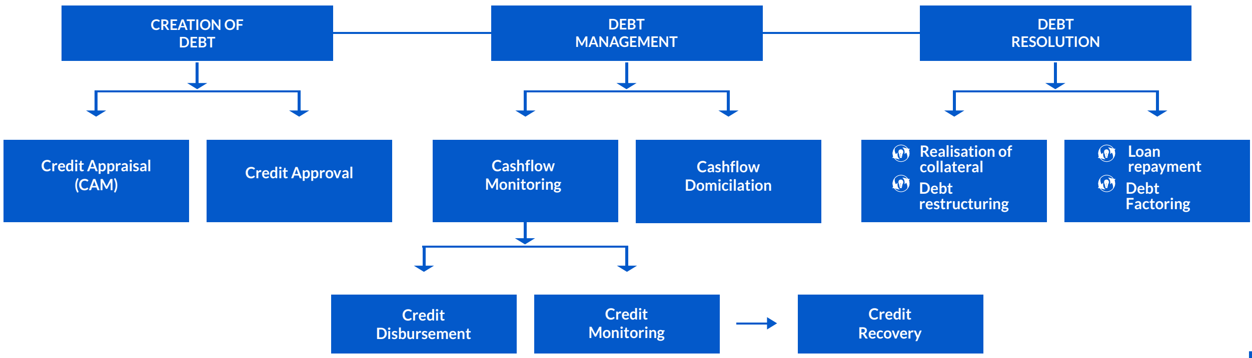


Credit Expansion and New Loan Strategies:
The Delinquency Register

Bank lending expansion has historically involved a rise in non-performing loans (NPLs) as the pool of bankable projects in the domestic money market are few and far between. A few problems with credit creation by local banks include but are not limited to:

"A robust global credit platform that gives lenders shared access to the nature of credit delinquency of each institution, especially as relates to "hardcore" debtors would protect the domestic credit market from credit predators and facilitate better conduct on the part of users of the domestic money market."

- Relatively weak credit appraisal (banks tend to emphasize the mechanics of lending with CAMs being poor replicas of earlier loan appraisals)
- Dependence on collateral assets rather than underlying project cash flows
- Modest scenario planning to grasp the macroeconomic impact of fiscal/monetary policy actions on the microeconomic realities of borrowers
- Weak data analytics and data mining of borrower's credit history.
  The absence of a global database of credit performance and ratings of borrowers creates ***adverse selection*** and ***moral hazard*** in the credit administration process. Adverse selection arises when borrowers have more information on their businesses than lenders and those with the worse credit status have the best incentive to seek loans. The ***asymmetric*** nature of credit information creates an environment of inefficiency in the lending process. Any arrangement that improves information sharing and knowledge of borrowers and their businesses increases overall market lending efficiency and reduces risk and lending costs. A borrower aware that one bank is unlikely to have detailed knowledge of his/her credit history in another bank, can "Rope-a-dope" by using inflows from one bank to create a dummy credit history in another bank and build false institutional credit confidence. A robust global credit platform that gives lenders shared access to the nature of credit delinquency of each institution, especially as relates to "hardcore" debtors would protect the domestic credit market from credit predators and facilitate better conduct on the part of users of the domestic money market.
- Shocks caused by public policy reviews and reversals. Sudden policy changes have historically created challenges for fundamentally good credit facilities before the introduction of new policies. Emerging markets such as Nigeria are characterized by sudden policy changes and lenders need to de-risk loans by pre-empting adverse policies and their impacts by adopting worse case scenarios that are potentially damaging but can be addressed by creative, even if, unconventional, credit protection arrangements.



A New Paradigm For A New Reality

In walking through the issues of resolution of delinquent assets of lenders, banks and their customers are going to have to enter into a new era of loan initiation, disbursement and recovery/repayment. The old paradigm is stunted and suffers from the following asset creation and management short comings:

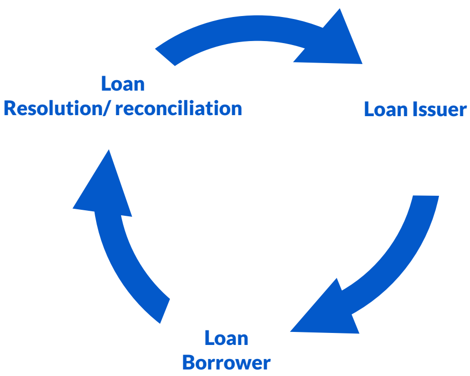
> ***"In walking through the issues of resolution of delinquent assets of lenders, banks and their customers are going to have to enter into a new era of loan initiation, disbursement and recovery/repayment."***

- Pre-approval assessment can take painfully long
- Customer character assessment has been largely a hit-or-miss affair
- Loan monitoring has been fragile and unengaged
- Loan recovery/remediation has been adversarial rather than fraternal
- Customers have had narrow leeway to work through loan repayment by way of loan restructuring and loan workouts

The new paradigm, however, assumes greater bank customer engagement and better pre-approval assessment and monitoring. The new loan framework follows a different algorithm as represented below:

- Credit Bureau rating review as base rate customer assessment criteria
- Project operating cash flow forecast that rests on base rate industry values for cost components and revenues
- ***Monte Carlo*** analysis of revenue risk/ project cost value at risk (VaR)
- Industry/project SWOT analysis with detailed risk modelling of
- revenues and costs
- Milestone-based credit disbursement schedules based on scaled completion deadlines against agreed project execution plans. At this stage the lender builds-in repayment lags and affirms critical path options and costs
- Loan monitoring and control involves one-on-one guidance of customer loan utilization and costing. The potential for loan diversion is reduced to a minimum as disbursements are choreographed in line with agreed repayment programmes which loan officers monitor and supervise closely
- Loan payback follows agreed anniversary dates but, in the event, that unexpected or unpredictable events take place (such as COVID-19), a loan resolution process is triggered immediately and a pre-agreed repayment framework is initiated at either the instance of the bank or the customer or both.
- Rather than lenders and customers finding themselves locked in interminable arguments over repayment plans and default on repayment edges, the pre-agreed resolution mechanism kicks-in and pulls the loan repayment process into a remedial default mode designed to restructure the Facility in a way that averts delinquency.
- A digital library of publicly available delinquent bank debtors provides lenders insight into the character and managerial capacity of borrowers. The digital library places both a moral and business burden on delinquent borrowers as prospective lenders would use the

The Lending Cycle



Source: Debtors Africa.com

library to fact-check the borrowing history of a loan applicant and use the history to set up a character rating index that would guide credit appraisal memorandums (CAMs) and inform the acceptance or decline of credit requests.

- The pressure of having lenders able to quickly and effortlessly review the nature of past loan facilities and repayment records of a prospective borrower creates a borrowing environment that is sensitive to historical loan performance data and past loan resolution difficulties. The register profiles the corporate boards of borrowing entities and helps lenders assess the fitness of company's leadership to borrower. Leveraging the psychology of 'social proofing', the failure of a borrower to abide by the terms of a loan agreement with one lender would put other lenders on notice to decline the loan request of a previously delinquent borrower until such a time the borrower redeems the earlier facility. The soundness of the psychology has been vindicated by the numerous requests from delinquent borrowers for media houses to bring down digital stories posted online or references to earlier delinquencies associated with the companies.

"The local credit market has evolved in sophistication but human beings have not evolved in character.

The governance compass in the corporate management of local enterprises in Nigeria is yet to see a major shift and if the business of lending is to be sustainable over the next couple of decades, new approaches to the model of granting credit must be cleverly crafted and firmly administered.

A good place to start would be a national registry of "hardcore" bank debtors."

Section 1 of the report expands on this theme against the background of an anticipated increase in delinquent loans in 2020 caused by a downturn in business spurred by the novel coronavirus pandemic (COVID-19). The likely rise in loan delinquency in 2020 as a result of supply chain disruptions, health lockdowns and suspension of corporate revenues may see bank's non-performing loans (NPLs) take a turn for the worse in the year. The digital online register of delinquent borrowers provided by debtorsafrica.com would, therefore, prove invaluable in the new lending ecosystem. The site would dissuade borrowers from bad behaviour and build a treasure trove of easily assessable data for global and national lenders. The new reality would be a massive reduction in information asymmetry and a better representation of an established nexus between borrower capacity and character and lenders willingness to lend.

Section 2 of this report takes an aerial view of the domestic credit market and highlights its major characteristics, participants, and institutional structures. The local credit market has evolved in sophistication but human beings have not evolved in character. The governance compass in the corporate management of local enterprises in Nigeria is yet to see a major shift and if the business of lending is to be sustainable over the next number of decades, new approaches to the model of granting credit must be cleverly crafted and firmly executed. A good place to start would be a national registry of "hardcore" bank debtors.

Section 3 of the report does a deep dive into the non-performing loan situation of banks in the country. The section reviews bank's profitability, asset quality, liquidity and leverage. Also, the section will review the sectoral distribution of hard-core debts and the impact of debtor characteristics on the growth of the domestic debt market.

Section 4 tackles issues of regulation and reviews regulatory provisions and approaches to debtor resolution.

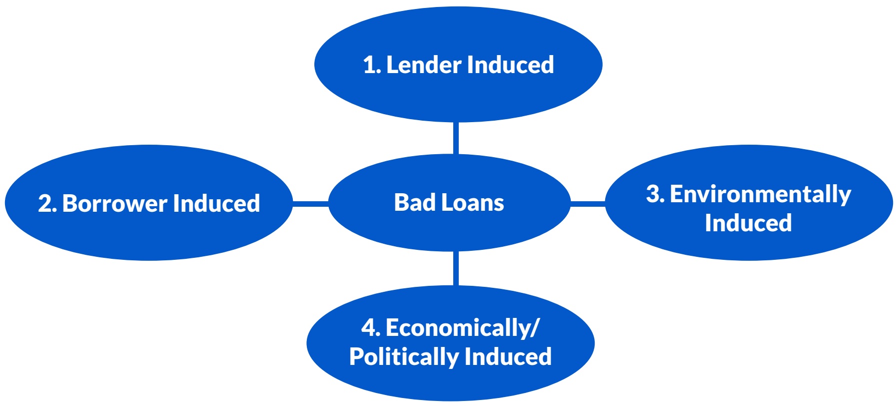
Section 5 discusses the bank debtor list and looks at the way a digital register of core and delinquent debtors could change the framework for the management of loan delinquency with greater effect. The new model goes beyond naming and so-called "shaming" to informing prospective creditors and other institutions that require character validation

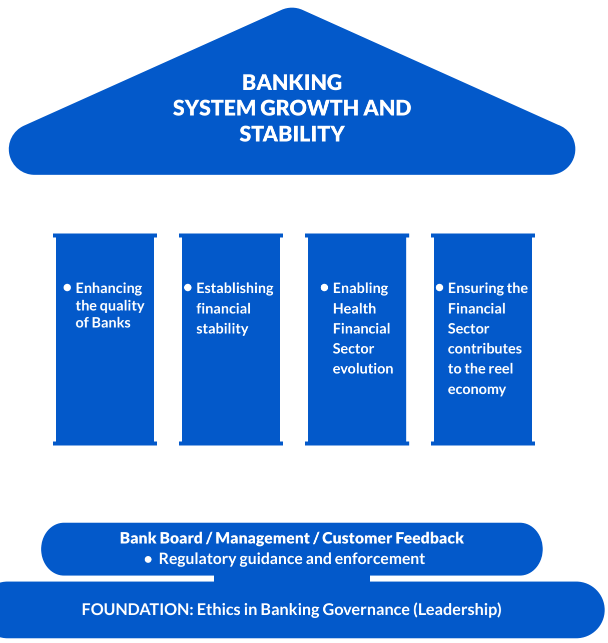
"The new model goes beyond naming and so-called "shaming" to informing prospective creditors and other institutions that require character validation."

Section 6 does a wrap up of the report and fleshes out the details of the new approach to managing debtor information, storage retrieval and referencing. The section explains how a searchable digital register of delinquent debtor would provide the new frontier of handling delinquency as it makes a case for a review of the country's bankruptcy laws.

Section 7 handles the "data bank" of the report providing the evidence-based pool of numbers upon which the report's analysis was premised. The section provides a mother lode of data on banks loans and deposits as well as operating performance over the last decade.

Major Factors That Make a Loan Go Bad





Stripping Delinquency of Its Secrecy

The banking sector, over the years, has been built on a raft of secrecy and confidentiality. A by-product of the culture of silence on bad conduct has been the exploitation of the rule by bad borrowers to support a system of increasingly non-performing loan (NPL) assets. Post COVID-19 the occurrence of delinquent bank loans would rise but a strong digital foray to unmask bad behaviour would strengthen the lending system's integrity as borrowers become circumspect about reputational damage that could result from flagrant disregard for loan repayment.

"The new law represents the beginning of what we have come to advocate as the new approach.

A systemic realignment of the Credit system around the principles of transparency and disclosure."

To counter the spike in borrowing misconduct, the Central Bank of Nigeria (CBN) on August 26, 2019 issued a circular to all banks, BSD/DIR/GEN/LAB/12/054 New Offer Letter Clause For Credit Facilities, stating, among other things, that:

1. With effect from August 26, 2019, the terms and conditions in offer letters and loan agreements must among others, contain the following undertaking to be signed by prospective obligors:

"By signing this offer letter/loan agreement and by drawing on the loan, I covenant to repay the loan as and when due. In the event that I fail to repay the loan as agreed, and the loan becomes delinquent, the bank shall have the right to report the delinquent loan to the CBN through the Credit Risk management System (CRMS) or by any other means, and request the CBN exercise its regulatory power to direct all banks and other financial institutions under its regulatory purview to set-off my indebtedness from any money standing to my credit in any bank account and from any other financial assets they may be holding for my benefit.

I covenant and warrant that the bank shall have power to set-off my indebtedness under this loan agreement from all such monies and funds standing to my credit/benefit in any and all such accounts or from any other financial assets belonging to me and in the custody of any such bank.

I hereby waive any right of confidentiality whether arising under common law or statute or in any other manner whatsoever and irrevocably agree that I shall not argue to the contrary before any court of law, tribunal, administrative authority or any other body acting in any judicial or quasi-judicial capacity."

The CBN by the circular removed the secrecy that hid banks and their debtors from the punishing rays of lending/borrowing clarity. The new law represents the beginning of what we have come to advocate as the new approach. A systemic realignment of the Credit system around the principles of transparency and disclosure.

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What We Do:

Debtors Africa curates and warehouses data on recalcitrant and delinquent debtors. Our searchable list is fully updated in real time (by contributors) and provides an accurate picture of the status of listed debtors with the entities so indicated. We support the empowerment of creditors to recovering debts through our various debt recovery tools, reports and channels.

Debtors Africa partners with creditors such as financial institutions, collection agencies, corporate entities, retail agencies and other certified entities to liquidate debts by providing a means tested repository of defaulters that is available for discerning users as a first level due-dilligence step to compliment the necessary credit review requirements for a fit and proper engagement.

This report was therefore commissioned to provide a wholesome review of the debtors landscape in Nigeria, as part of a series of reports to be issued on sovereigns and the continent as a whole.

Disclaimer:

We have made reasonable efforts to present accurate and reliable information in this Report; however, Debtors Africa is not responsible for any errors in or omissions from the information contained in the Report, nor is Debtors Africa responsible for the timeliness of the information. The information in this Report is not intended to provide specific advice about individual legal, business, financial or other questions, and it is not a substitute for users' independent research and evaluation of any issue. If specific legal, financial or other expert advice is required or desired, the services of an appropriate, competent professional should be sought.

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This report was published on May 14th, 2020 and is based on the verified publicly available information at that time. This PDF version was created on May 13th, 2020, without variation to the content. To check for updates, kindly visit www.debtorsafrica.com or send an e-mail to info@debtorsafrica.com. Thank you.

Acknowledgement

We recognize our Technical Partners, proshare, in the Research, Analysis and Production of this publication. The Proshare research team covered representations from three capital market regulators, two of the three local Credit Bureaus, three bank contributors, 30 subject matter specialists including two Asset Management Professionals (AMPs) and ten senior bank executives with responsibility for credit origination and management, two senior executives from each of the interviewed Credit Bureaus, two audit specialists on issues related to IFRS9 and six Investment Banking specialists with experience in transactions related to off-balance sheet bank activities and asset securitization and debt restructuring.

A number of senior staff were interviewed from banks, credit bureaus, regulatory agencies and professional bodies. To obtain further details about this report kindly contact *content@prosharent.com*

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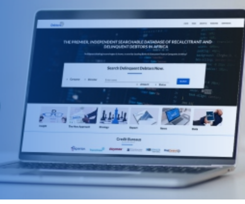

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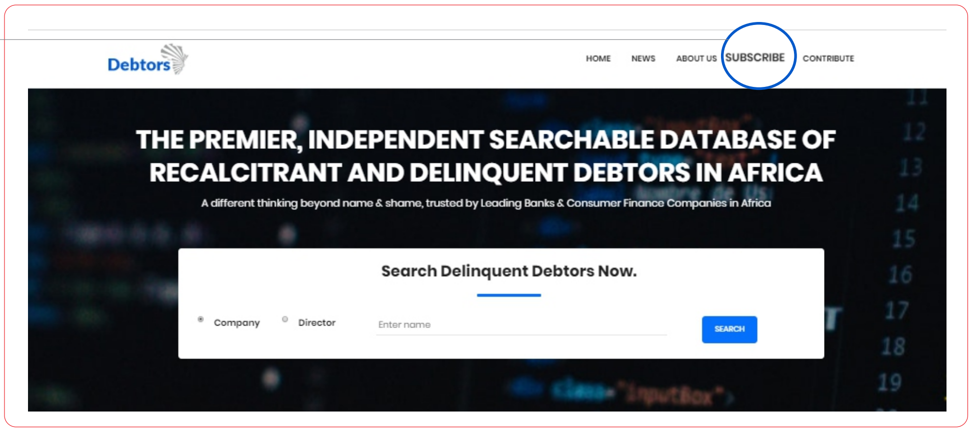

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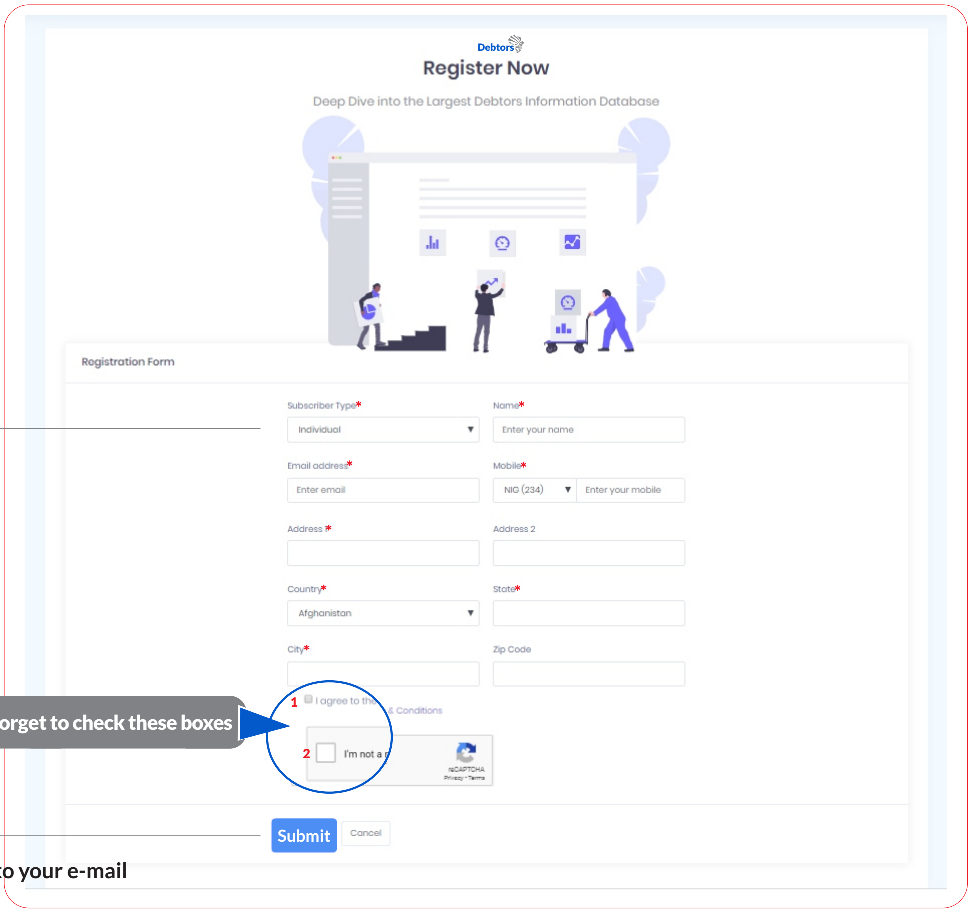

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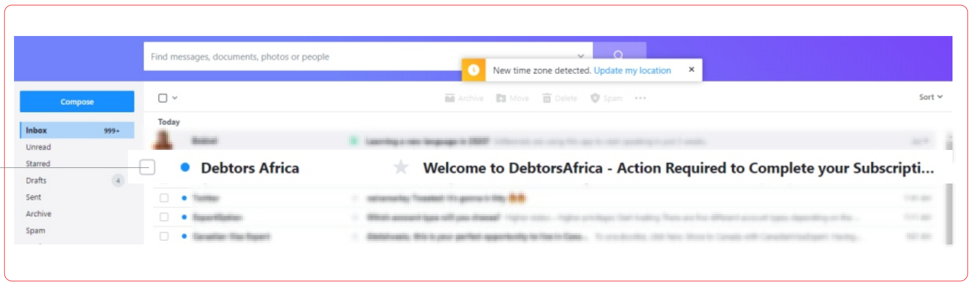
STEP 3 Click submit

A verification link will be sent to your e-mail

STEP 4 Open the e-mail sent to you



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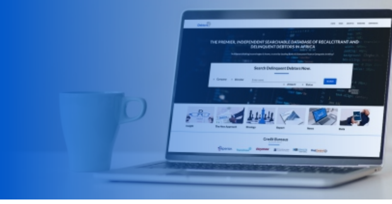
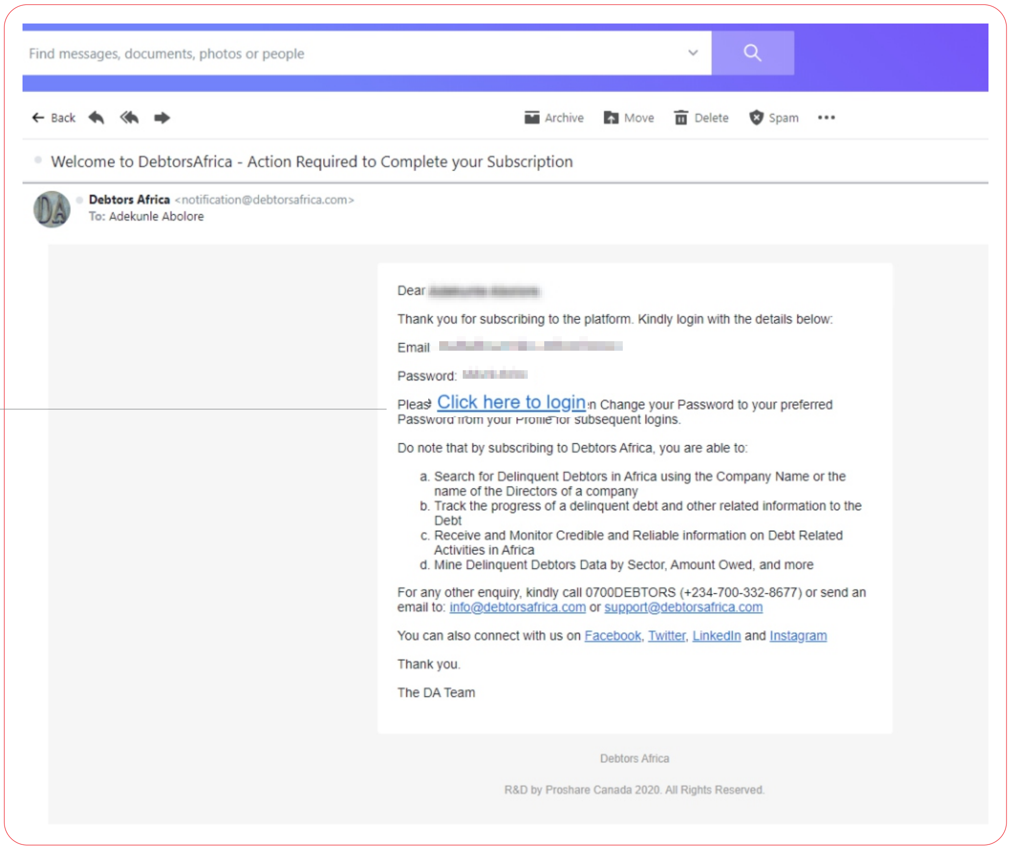
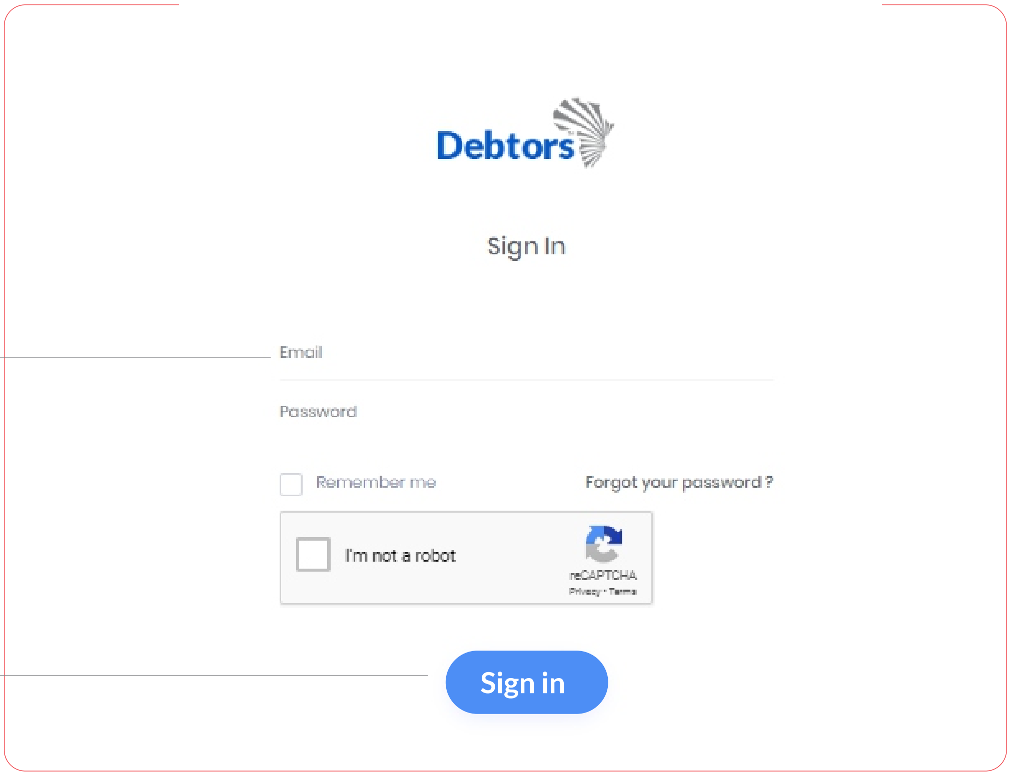


STEP 5 Click on the link to login



STEP 6 Enter your login details

FINAL STEP Click on Sign in



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